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Supreme Court of the United States

OCTOBER TERM, 1938.

No. 9.

GUARANTY TRUST COMPANY OF NEW YORK, EXECUTOR OF THE ESTATE OF MARY T. RYAN, DECEASED,
PETITIONER,

v.

COMMONWEALTH OF VIRGINIA,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF VIRGINIA.

REPLY BRIEF ON BEHALF OF PETITIONER.

JAMES R. CASKIE,
Attorney for Petitioner.

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In this reply brief, we shall endeavor to treat seriatim the various matters under the subject headings, as set out in the Brief of Respondent, the figures after each referring to the pages of that brief.

STATEMENT OF THE CASE (pages 2-3).

In this statement the brief at page 3 states that the grounds relied on by Petitioner for relief were only two—viz.:

"First: The Virginia statutes were said not to have the intent of taxing the income paid Mrs.

Ryan from the New York trust (Record, pp. 3, 4) and

"Second: Even if the tax were intended, it was claimed that its levy violates the 'Due Process Clause' of the Constitution of the United States. (Rec., p. 15)."

Reference to the record pages cited will show that neither on page 3 or on page 15 did the "Second" ground mention the "Due Process Clause" but both claimed the tax as unconstitutional "under the Fourteenth Amendment to the Federal Constitution" (Rec., p. 3) and "Contrary to the Provisions of the Fourteenth Amendment to the Federal Constitution (Rec., p. 15).

It is true that it was stated (Rec., p. 15) that "The Fourteenth Amendment is what is usually referred to as the Due Process Clause." This statement is obviously inept since the Amendment has a number of clauses of which the Due Process Clause is only one.

The question as to whether the ground of violation of the Equal Protection Clause of that Amendment was raised in the Court below will be discussed in order under that head.

ARGUMENT.

I.

"The Petition Was Not Filed in Time," page 5.

We feel that but little need be said on this subject, beyond what was said in the "Petition for Writ of Certiorari," filed in this Court, at pp. 9 and 10.

The decisions of this Court cited on page 10 were dismissed with the mere statement that they do not apply. It is insisted that they do apply. In any event, the Virginia Statute Sec. 5871 (Petition, p. 9) would seem to conclude the question.

The Virginia Court under the statutes held separate and independent "Sessions" or Terms at different points, with separate and independent Clerks for each point. (See Brief in Opposition to Petition for Writ of Certiorari, p. 8). The instant case was at the Staunton Court of which the Clerk was H. H. Wayt who certified the record (Rec., p. 49). The case was decided and opinion rendered on November 11, 1937, in vacation of the Staunton Court, and at a term of the Richmond Court, of which M. B. Watts was Clerk (Rec., p. 42) and that Clerk, pursuant to the statute certified the order to the Clerk at Staunton where the final judgment was entered on November 23, 1937.

The statute (Sec. 5871) specifically provided that the Court might at any place of session "enter any order or decree in any cause originally docketed at any other place of session," and provided that when so made the order shall be certified by the Clerk, at the place where the Court is then sitting to the Clerk at the place where the cause was originally docketed, there to be entered on the proper order book and "When so made *and entered* shall have the same force and effect as if made and entered in term." (Italics supplied.)

The cause was not on the docket at Richmond, and was not pending there. It was pending and on the docket at the Staunton Court. Obviously, there could be entry of final judgment until entered where the case was pending and the statute so recognized and provided.

In view of the facts and the statute (Code Sec. 5371), we cannot follow nor do we see the relevancy of the argument or of the Rules of Court, which, incidentally, are not in this record, nor of Virginia Code section 6872, as set out on pages 5 and 6 of the Brief in Opposition to the granting of the Writ of Certiorari and dealing

with rehearings in the Virginia Court, except to call attention to the fact that the statute quoted, like section 5871, recognizes and requires the certifying to and entry of the judgment or order on the order book at the place of session *where the case be pending*.

II.

"The Due Process Clause of the Fourteenth Amendment," page 6.

A.

"Inherent Jurisdiction to Impose a tax on the entire net income . . .," etc., pages 7-12.

In the treatment of this subject, Attorneys for the Respondent apparently labor propositions not disputed or denied as *general* propositions viz.: that Income taxes are a valid method of taxation; that the receipt of income is a taxable event (whether such income be from sources within or without the State) and that domicile itself establishes a basis for taxation. However, all rights of taxation are subject to such limitations as the Constitution may prescribe.

It is the limiting effect of the Fourteenth Amendment, as repeatedly recognized by this Court, and as set out in the quoted case of *Lawrence* v. *Mississippi* (opposing brief p. 8), which is in issue here. The quotation, after setting out the right of a state to levy income taxes on its residents and that the Federal Constitution states no particular mode of taxation and States are thus left unrestricted in their power to tax those domiciled there, sets out that such rights exist only

> "so long as the tax is upon property within the state or on privileges enjoyed there, and *is not so*

palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment . . ." (Italics supplied.)

This is recognized in the opposing brief (p. 12) where the conclusion on this subject states that the argument is made "laying aside the question of double taxation"—and it might have been added—"and the question of equal privilege," or else should have read "laying side the question of the Fourteenth Amendment."

On pages 11 and 12, the attorneys for Respondent present the view that a net income tax is by the great weight of authority regarded as an excise and cites numerous authorities. This likewise is not denied as an *ordinary* proposition, and has been so recognized in decisions of this Court. However, for *Constitutional purposes* this Court has consistently refused to so classify it. In the case of *Lawrence* v. *Mississippi*, 286 U. S. 276, 280, 76 L. Ed. 1102, 1106, cited and relied on by Respondent, the Court specifically refused to so classify a net income tax for the constitutional question, though the State Court had so defined it (as was done by the Virginia Court in *Hunton* v. *Commonwealth*, 166 Va. 229, 244, 183 S. E. 878, as quoted on page 11 of Respondent's brief).

In the *Lawrence* case the Court, after referring to the State Court decision defining the tax as an excise, said "but in passing on its constitutionality we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it."

In this connection we refer also to the authorities cited on pages 20-21 of the Brief accompanying the Petition for Writ of Certiorari and which Brief is used as our opening brief in this case. The authorities there cited answer fully the contention on this question and

hold that the general classification of an income tax as an excise does not apply to constitutional questions and that for such questions an income tax does not—

> "fall within the class of excises, duties or imports in the Constitutional sense, but is in such sense a direct tax on property from which the income is derived."

B.

"The Inherent Jurisdiction of Virginia to impose a tax upon the Entire Net Income is not Defeated, Divested, or Ousted, etc." Pages 12-21.

At the outset, as shown above, the "inherent right" of Virginia is only *inherent* "so long as the tax imposed . . . is not so palpably arbitrary or unreasonable as to infringe on the Fourteenth Amendment . . .," or as recognized by the opposing brief is inherent only "laying aside the question of double taxation," i. e., laying aside the question of the Fourteenth Amendment. The Amendment is not to be "laid aside" as that is the question at issue here and to be decided.

It is not necessary here to discuss the moot question of whether "double taxation is *per se* bad and that this Court has said that the Fourteenth Amendment does not prohibit double taxation." This Court has held repeatedly and reiterated in the cases cited on page 13 of Respondent's brief and on pages 18-19 of the Brief in support of the Petition for Writ of Certiorari that—

> *"The Fourteenth Amendment prohibits taxation by two or more States of the same subject, and that such double taxation deprives the owner of due process of law"*

The attorneys for Respondents in their brief, at pages 14 and 15, refer to the four cases of *Farmers Loan & Trust Co.* v. *Minnesota*, 280 U. S. 204; *Baldwin* v.

Missouri, 281 U. S. 586, *Beidler* v. *South Carolina*, 282 U. S. 1, and *First National Bank of Boston* v. *Maine*, 284 U. S. 312, as cases in which the Court applied the Fourteenth Amendment to forbid double taxation on "intangibles." Obviously they are in error for in none of these cases was the question of a property tax involved. All four involved an *excise tax*—i. e., death transfer, or succession tax, the amount of the tax being based on the value of the intangibles transferred, as is true of all such succession taxes.

As shown, for Constitutional questions an income tax is regarded not as an excise tax but as a property tax. and so double taxation by two or more states of the same subject would seem to come clearly within the protection of the Due Process Clause under the decisions cited.

Even if this last position be not accepted and the income tax should be held for Constitutional questions to be an excise, contrary to the decisions cited, Respondent would still be in no better position for the ruling applies equally as well to an Excise tax as to a property tax, as shown by the four cases cited last above. This would seem to be necessarily true, for the Fourteenth Amendment (Due Process and Equal Protection clause) is a general provision mentioning no specific subjects. Certainly, a citizen is entitled to due process and equal protection as much in respect to tax on income as to tax on property and double taxation is no less hurtful or objectionable on one than on the other and is necessarily subject to the same principles as to both.

It would seem that the principles announced in the decisions and which were successively applied to Tangible personal property (*Union Refrig. Co.* v. *Kentucky*, 109 U. S. 194 (1905); Tangible personal property which had acquired no situs elsewhere than at owner's domicile, though never physically present there (*Southern Pacific*

Co. v. *Kentucky*, 222 U. S. 68 (1911); Tangibles located permanently outside of the domiciliary State (*Frick* v. *Pennsylvania*, 268 U. S. 473 (1925); Intangibles (*Safe Deposit & Trust Co.* v. *Virginia*, 280 U. S. 83 (1929); Excise transfer tax on bonds of cities and residents of non domiciliary state (*Farmers Loan & Trust Co.* v. *Minn.*, 280 U. S. 204 (1930); Excise transfer tax on cash, credits, promissory notes and second mortgages due by residents of non domiciliary state and secured on property therein (*Baldwin* v. *Missouri*, 281 U. S. 586 (1930); Excise transfer tax on debt due by Corporation of non domiciliary state (*Beidler* v. *South Carolina*, 282 U. S. 1 (1931); and Excise transfer tax on stocks of Corporations of non domiciliary state (*First Nat'l Bank of Boston* v. *Maine*, 284 U. S. 312 (1932); would for like reasons and considerations apply equally as well to double taxation on income and that the effort to distinguish on the ground that the tax is an excise, which was urged without success in the four cases last cited, should be refused here even as it was in those cases, and even if it be considered as an excise for the question of Constitutional objections.

As has been already noted in our Brief in support of the Petition for Writ of Certiorari, the two cases of *Lawrence* v. *Mississippi*, 286 U. S. 276, and *New York ex rel Cohn.* v. *Graves*, 300 U. S. 308, in which Respondent places its chief reliance, while they do uphold the right of a State to tax income received from work done or property located in another state, yet they have no bearing on the question of double taxation, since no such question was involved in either case. It is not denied that a *basis* for taxation exists in the present case in the residence of Mrs. Ryan in Virginia. The fact that such basis exists cannot overrule the constitutional prohibition, which comes into effect only when two or more states, each with a basis for taxation, attempt to tax the

same subject, and until such attempt be made either state may on the strength of its basis apply its tax. In every one of the cases where the double taxation was prohibited each of the states had a clear basis for its tax, and the Court decided which had the prior and therefore the only right, where conflict actually existed. Not one of the cases was decided adversely to the claimant state on the ground of want of *basis* for its tax. In fact, if that be the test then the question of "double taxation" could not come into play, or be or any importance, for if there be no basis for the tax it would fall of its own weight, and the cases would have been decided on that want of basis for its tax rather than the question of violation of the Constitutional provision in oppressive and unreasonable double taxation.

The case of *Shaffer* v. *Carter*, 252 U. S. 37, cited on pages 7 and 18 was decided long before *Blackstone* v. *Miller* was overruled and before the double taxation cases cited above, from *Frick* v. *Pennsylvania* through *First National Bank of Boston* v. *Maine*, and has no bearing on the question here in view of the recent views of the Court on double taxation. No question of double taxation was involved.

In this connection it would seem proper to refer to the case of *Maguire* v. *Trefry*, 253 U. S. 12, and the subsequent treatment of that case in *Senior* v. *Braden*, 295 U. S. 422.

These two cases are fully discussed in the Petition for Writ of Error filed in the Virginia Court (Rec., pp. 15-18), to which we refer, and they need not be treated in detail here.

In *Maguire* v. *Trefry*, the Court sustained the right of Massachusetts to tax to one of its residents income received from a Pennsylvania trust *to the extent to which the income had not been taxed by the Home State of the Trust*. There was no question or suggestion in

that case that Massachusetts could have taxed income which had been taxed to the trust in Pennsylvania.

In *Senior* v. *Braden*, *Maguire* v. *Trefry* was discussed as to the holding above. The Court disapproved the Maguire case saying:

> "There the Massachusetts statute undertook to tax income; the securities (personalty) from which the income came were held in trust at Philadelphia; *income from securities taxable directly to the trustee was not within the statute.* The opinion accepted and followed the doctrine of *Blackstone* v. *Miller*, 188 U. S. 189, 47 L. ed. 439, 23 S. Ct. 277, and *Fidelity & C. Trust Co.* v. *Louisville*, 245 U. S. 54, 62 L. ed. 145, 38 S. Ct. 40, L. R. A. 1918 C. 124. These cases were disapproved by *Farmers Loan & Trust Co.* v. *Minnesota*, 280 U. S. 204, 74 L. ed. 371, 50 S. Ct. 98, 65 A. L. R. 386, *and views now accepted here in respect to double taxation.*" (Further cases cited.) Italics supplied.

For fuller discussion see Rec., pp. 15-18.

IS THERE "DOUBLE TAXATION" IN THIS CASE?

We cannot take seriously the contention that if there be a conflict of rights, Virginia should have priority over New York. The trust is a trust set up under the will of a resident of New York, made to New York Trustees, the assets are kept in New York, and the trust is managed and controlled in and under the laws of New York, and all the income is collected there. The effect of the case of *Maguire* v. *Trefry* (supra) clearly shows the prior right of the domiciliary State of the trust over the domiciliary State of the beneficiary and the effect of the disapproval in *Senior* v. *Braden* strengthens the priority of the State of the Trust, since the latter case disapproves the holding that the State of domicile of

the beneficiary could tax income from the trust even when not taxed in the State of domicile of the Trust. In short, the effect of the two decisions is to fix the situs for taxation of trust income in the State of the domicile of the trust and to prohibit its taxation in the other State.

This brings us to the contention that there is no "Double Taxation" in the Constitutional sense in this case as the taxes were assessed on different entities, i. e., the Trustees in New York and the beneficiary in Virginia.

It is submitted that for taxation purposes the Trustee and the beneficiary are one and the same and that a tax on the Trustee is a tax on the beneficiary who is in fact the beneficial owner of the entire net assets and income of the Trust. A Trustee is a mere fiduciary agent of the beneficiary. As said by this Court in *Gridley* v. *Wynant*, 23 How. 500, 502, 16 L. Ed. 411:

> "A trustee in equity is regarded in the light of an agent for the *Cestui qui trust*, and the authority confided to him is in the nature of a power."

Cited and quoted in *Insurance Co.* v. *Waller* (Tenn.) 95 S. W. 811, 815, 115 Am. St. Rep. 763, 7 Ann. Cas. 1078.

A trustee is one in whom some estate, interest or power in or affecting property of any description is vested for the benefit of another.

Taylor v. *Mayo*, 4 S. Ct. 147, 150, 110 U. S. 330, 28 L. Ed. 163; *Alleghaney Tank Car Co.* v. *Culbertson*, 288 F. 406, 410; *Catlett* v. *Hawthorne*, 157 Va. 372, 161 S. E. 47, 48.

The *cestui qui trust* is thus the beneficial or equitable owner of the net assets and income of the trust. Any charge against the income in the hands of the trustees directly and inevitably decreases the amount of the income which belongs to and must be paid to the *cestui qui trust*. The tax charged to the trustee does not effect

him or his income in any way—the tax is a direct tax on income belonging to the beneficiary and in actual effect and operation is a direct tax on the beneficiary as beneficial owner.

It is submitted that as to questions of taxation the Trustee and beneficiary are not to be distinguished and a tax on the Trustee is actually a tax on the beneficiary who, and who alone is the loser. So far as taxation is concerned, they are one and the same.

The case of a Trustee and beneficiary and the cases of Corporation and Stockholders, Profit on sale of stock on the New York Exchange by a resident of Virginia and a resident of one state earning income from personal services, as referred to on page 19 of Respondent's Brief are readily distinguishable.

In the case of Corporation and Stockholders, the Corporation is both legal and equitable owner of its assets and income; and manages and controls both as it may see fit; the stockholders have no ownership of the assets or net income, as such; the Corporation can and does use the income for such corporate purposes and objects as may be desired and the stockholder has no rights in such income as such; their rights are only to dividends out of income (or surplus) in such amount and as and when the Corporation deems advisable and wise to declare.

The reference to the case of sale of stock on the New York exchange is obviously inept. In such case there is no basis for tax in New York on the profit realized and no question of double taxation could arise.

Likewise the reference to the case of wages or salary earned in another state is inept. There the employee is not interested in or affected by taxes paid by the employer. He gets his full wage and no possible question of double taxation of the same subject arises unless both states attempt to tax the income to the employee. In

such case we would have the identical question at issue here. Under our contention only one state could tax the income and the Court would decide as to the priority of right as between the two states, just as this Court has done in all the "double taxation" cases referred to above.

Respondent's brief (pp. 13-14) suggests the difficulty of determining as to priority of right as between the states involved. Suffice it to say that constitutional rights of citizens will not be disregarded because of the *difficulty* in determining the rights as between the States. Furthermore, as shown above, in the decided cases on the question of "Due Process and Double Taxation," this Court has apparently perceived no such difficulty or if so has solved the difficulty and determined the question as to the right of priority.

III.

The Equal Protection Clause (p. 17, etc.).

The position of Respondent on this question is twofold:

First—That this defense was not raised in the Virginia Court, and

Second—That in any event our position is not sound.

First: The contention was made in the Virginia Court.

In the Virginia Court the position of petitioner was (a) that, when properly construed, the Virginia statutes did not authorize the imposition of the tax and (b) that if so it was forbidden by the "Fourteenth Amendment" to the Federal Constitution, which amendment contains both the Due Process Clause and the Equal Privilege Clause.

It is true that in the arguments made on the Constitutional question the "Due Process" clause was stressed,

and there was no *detailed separate* treatment of the Equal Privilege Clause. The reason for this was that the question of Equal Privilege was discussed under the argument as to the construction of the Virginia Statutes, and that to construe them as to impose the tax would violate the equal rights of Petitioner, in that it would impose on her as beneficiary of a discretionary trust double taxation which could not be and was not imposed on beneficiaries of an ordinary trust. This doubtless explains why the opinion of the Virginia Court did not deal separately with the Equal Privilege Clause under its treatment of the Constitutional question. It had decided against our contention as to equal rights under its treatment of the question of Construction of the Statutes. Apparently it practically ignored the constitutional point. In any event, we are not bound by what the Virginia Court said were our contentions; the record must speak on that question.

The Petition for Writ of Error filed in the Virginia Court did not specify any particular clause of the Fourteenth Amendment in the presentation of the "Questions before the Court," but stated (Rec., p. 3):

> "Second. If the statute be construed to make the income taxable in Virginia, it would be unconstitutional under the Fourteenth Amendment to the Federal Constitution."

In that Petition (Rec., p. 11) Petitioner called specific attention to the violation of the equal rights of Petitioner by the construction contended for by the Commonwealth.

Attention was again called in that Petition (Rec., p. 22) to the fact that to sustain the contention of the Commonwealth would, under the statute, be unconstitutional under the decisions of this Court.

We quote from the Reply Brief filed by the Petitioner in the Virginia Court. The concluding paragraph of that Brief is as follows:

> "It is respectfully submitted that the tax in this case is not authorized under the Virginia Statutes, when they are all read together and the obvious intent and purpose thereof are considered, and to hold otherwise would bring the tax in conflict with the Fourteenth Amendment of the Constitution, *both on the ground of double taxation and on the ground of discrimination against a beneficiary of a discretionary trust.*" (Italics supplied.)

That the defense of violation of the Equal Privilege Clause was made, whether considered by the Virginia Court, or not, seems clear.

Second: The Tax in Question Violates the Equal Privilege Clause of the Fourteenth Amendment.

We feel that this point has been sufficiently covered in our Brief accompanying the Petition for Writ of Certiorari, and that no sufficient answer has been made by Respondent in its treatment of the subject on pages 23 and 24 of its Brief. To sustain Respondent's view of the question where there is a Virginia discretionary trust and a Virginia beneficiary, it would be necessary to disregard the actual wording of the Virginia Statutes (Sections 24 and 50) and read into Section 24 (as we contended should have been done when the statutes were considered together), a qualifying phrase to make the last clause (see Respondent's Brief, Appendix, p. 27), read as follows:

> "including . . . income derived through estates or trusts by the beneficiaries thereof, whether as distributive or as distributable shares" *to the extent that such income has not been taxed to the Trust.* (Addition italicized.)

Our contention was that so far as Discretionary Trusts were concerned, Sections 50 and 51 of the Virginia Tax Code covered the field of income taxation as to income therein wholly taxed.

Our contention was resisted and overruled. Now Respondents apparently adopt it, certainly as to a Virginia Trust and a Virginia beneficiary. Otherwise, there would necessarily be a tax on both the Trustee and the beneficiary on the same income. Section 50(d)—(4) (Rec., pp. 44-45) requires the Trustee to pay tax on the income without deduction, and so it would be paid.

Section 88 (Rec., pp. 44-45) taxes individuals and Section 24 (Rec., p. 44) requires such individual to include in the gross income "income derived through estates or trusts." The statutes thus on their face would require the taxation of income paid to the beneficiary of a discretionary trust both to the trusts and to the beneficiary.

It was this consideration which actuated our contention that the qualifying phrase should be read into section 24, otherwise the statute would be discriminatory and violate both the Due Process Clause and the Equal Privilege Clause of the Fourteenth Amendment. The Virginia Court denied our Contention.

Respondent having contested our position and prevailed in the Virginia Court now apparently for the hearing here adopts it. They should not blow both hot and cold.

CONCLUSION.

It is submitted that the judgment of the Virginia Court should be reversed.

Respectfully submitted,

JAMES R. CASKIE,
Attorney for Petitioner.

Lynchburg, Va.